

DIVERSITY IN THE MANAGEMENT OF INVESTMENTS 2014 PROGRESS REPORT

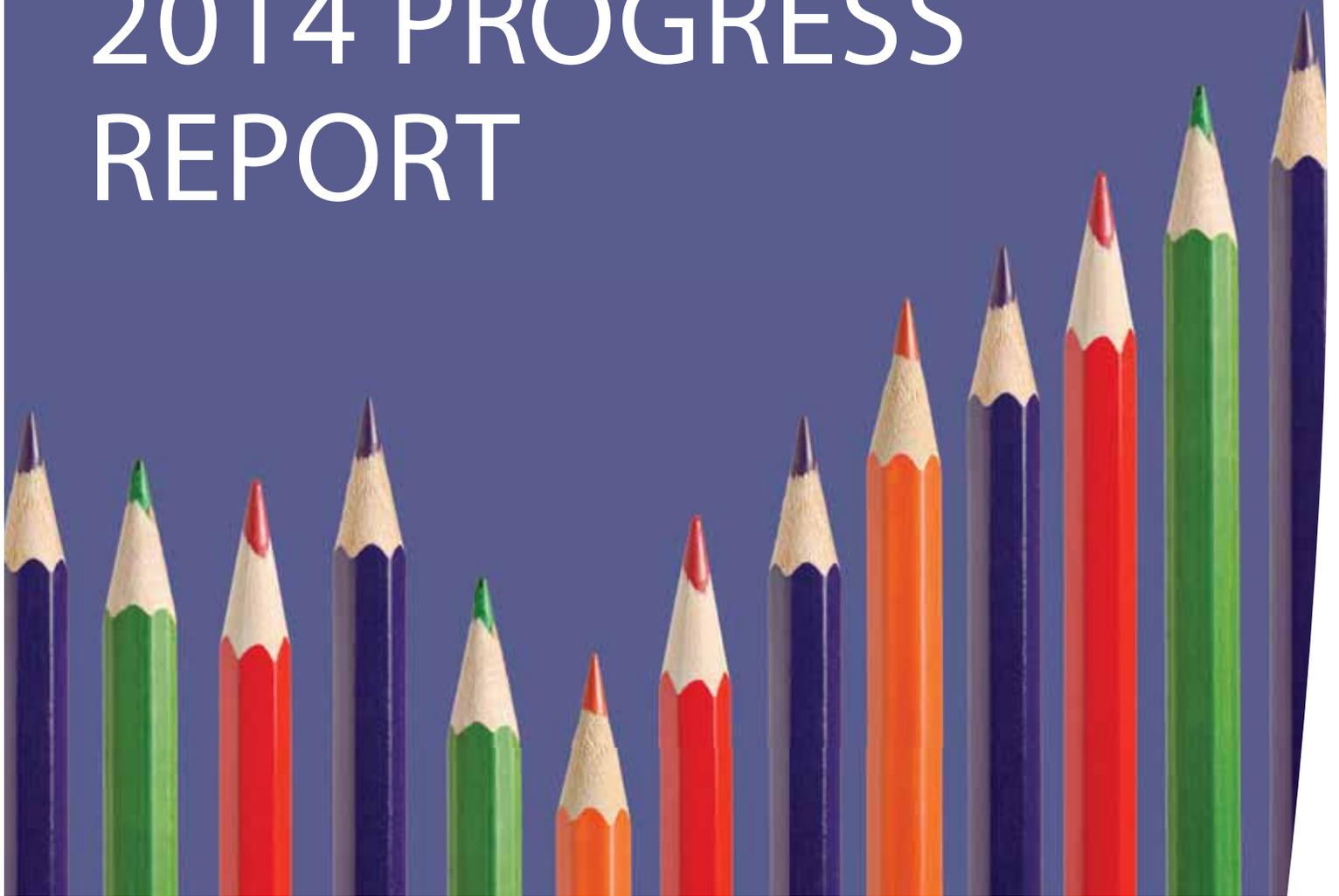


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MISSION Securing the financial future and sustaining
The trust of California’s Educators

VISION Your Reward – a secure retirement
Our Reward – getting you there

CORE VALUES **Customer Service** – We never compromise on quality as
we strive to meet or exceed the expectations of our customers.

Accountability – We operate with transparency and
accept responsibility for our actions.

Leadership – We model best practices in our industry and
innovate to achieve higher standards.

Strength – We ensure the strength of our system by
embracing a diversity of ideas and people.

Trust – We conduct ourselves with integrity, acting ethically
in every endeavor.

Respect – We respect the needs of our members, co-
workers, and others, treating everyone with fairness, honesty,
and courtesy.

Stewardship – We recognize our fiduciary responsibility
as the foundation for all decision-making.

INVESTMENTS CORE VALUES

The CalSTRS Investments Branch core values are a set of attitudes, beliefs, and behaviors that define CalSTRS and its employees.

Respect – We strive to not only treat others as we would like to be treated, but to go the extra mile and treat others as they would like to be treated.

Personal Development – We support an individual’s career and personal goals.

Balance – We encourage employees to balance a strong work ethic with interests outside of the office.

Worth – We strive to recognize everyone’s efforts and contributions to the organization.

Challenge – We are honored to accept the challenges placed upon us and strive to create an innovative work environment.

Purpose – We work toward a common goal, thereby making a difference for others and ourselves.

Honesty – We are truthful to ourselves, to peers, to supervisors, the Board and to the organization; our word is our bond.

Introduction

The Diversity in the Management of Investments report has been submitted as requested by the CalSTRS Investment Committee. In addition, Senate Bill 294 (Chapter 701, Statutes of 2011), by Senator Curren D. Price, Jr., has multiple requirements in the utilization of emerging investment managers, the majority of whom are people of color due to the changing demographics in the country. The measure requires the development of a 5-year strategic plan, and that an annual report be submitted to the Legislature that would present information regarding progress toward achieving the goals of the plan. CalSTRS has had a Board-approved strategic 5-year plan in place since February 2011. The intent of this annual progress report is to provide an update, to include information on the progress CalSTRS has made concerning DMI and SB 294.

Consistency of Philosophy and Action

CalSTRS seeks to honor the philosophy of inclusion, long reflected in California educators, while maintaining a financially sound retirement system. Diversity in the management of investments is interwoven in the investment business goals and is consistent with the objective of investing to enhance the returns at a prudent level of risk, in accordance with CalSTRS Investment Policies, the California Constitution, and the Education Code.

In order to ensure diversity in the management of investments, we must obtain exposure to a wide gamut of investment opportunities and talent. This exposure must be acquired in a comprehensive and strategic manner, under the

leadership of the Chief Investment Officer and consistent with the direction that the CalSTRS Board has given through its core values. Specifically, Diversity in the Management of Investments (DMI) operates under the CalSTRS core value of:

Strength – We ensure the strength of our system by embracing a diversity of ideas and people.

We keep the CalSTRS Board apprised of our efforts with the annual Diversity in the Management of Investments Report, and the California Report.

DMI is accomplished with a diverse Investments staff (108 people), that is also multi-ethnic and multi-cultural with various worldviews and investment perspectives. Part of the strategy includes our involvement in communities of color through organizations that have become strategic partners. This year, CalSTRS has once again been recognized by the Association of Asian American Investment Managers (AAAIM). In November 2013, CalSTRS received the AAAIM Champion's award. The notification letter indicates that "AAAIM's Champions Award is given to trailblazers who support greater diversity and inclusion in the industry. CalSTRS' leadership in promoting greater hiring of diverse employees and portfolio managers is a shining example of dedication to this important cause."

Also, in November 2012, Solange F. Brooks, Portfolio Manager, Investments Executive Unit, was honored with the New America Alliance (NAA) Pension Leadership Award for

Promoting Latino Advancement. As with AAAIM, the organization had previously awarded the Distinguished Service Award for Advancing Latinos in American Business to Christopher J. Ailman, CalSTRS Chief Investment Officer (2006). These recognitions serve as an indicator to demonstrate that CalSTRS is a leader in the space and is a consistent, long-term partner that has embraced DMI.

In 2013, we established a DMI Team with representatives throughout all Investment's asset classes. This effort facilitates the communication of activities that enhance DMI efforts and keeps everyone apprised of developments.

The Asset International Chief Investment Officer (aiCIO) Innovation Award was bestowed to CalSTRS Investments in December of 2013. It speaks highly of Investment staff and the culture of CalSTRS. Earlier that year, Aeisha Mastagni, Investment Officer III within the Corporate Governance Unit was named to the Top 40 Under 40 Investment Officers across the globe, and Chief Investment Officer Christopher J. Ailman received the number three spot in aiCIO magazine's 2013 Chief Investment Officer Power 100. The list ranks and profiles the 100 most influential and powerful asset owners in the world. Mr. Ailman was the first on the list from the United States in 2013. The individual accomplishments of the Investment Branch could not have been possible without the support of the entire investment staff, the teamwork approach, and the following featured units.

Investment Operations

Investment Operations' overall goal is to align the services and functions of all asset classes and investment strategies for the successful implementation of the Investment Policy and Management Plan. The unit's core services include (i) cash forecasting and cash movement; (ii) trade processing and cash-security settlement; (iii) position, cash and trade reconciliation; (iv) collateral management; (v) corporate action processing; (vi) operational risk management and compliance; (vii) market openings; (viii) various investment and SEC surveys; (ix) and portfolio hierarchy and total fund reporting. Most of these processes have been identified as mission critical in the Investment Business Continuity Plan.

Additionally, Investment Operations provides critical cash flow information to Investment Management to ensure sufficient cash balances are available to pay benefits to our members. They also coordinate and manage strategic business partners such as the global master custodian and facilitate the delivery of services from internal business partners to the Investment Branch.

It is often said that Investment Operations is an integral part of the Investment Branch. Similar to the rest of the Investment Branch, the source of our strength stems from many different ideas and people – a wide range of professionals with diverse backgrounds.

Infrastructure

Infrastructure is part of CalSTRS Investments Inflation-Sensitive Program approved by the Board in 2008 to provide improved diversification to the overall CalSTRS Investment Portfolio and to provide a hedge against inflation and long-term liabilities, among other reasons. Dedicated staff was allocated in 2010, and provided the first infrastructure investment recommendation to the Board later that same year. The Board approved the investment, and has since approved and allocated \$1 billion to five managers worldwide. This budding program is managed by a small, diverse team of two professionals supported by the work of student assistants. It seeks to employ and retain experienced investment managers that possess superior capabilities in the proven selection and management of infrastructure assets. With this objective in mind, prospective investment managers shall be evaluated for selection based on criteria including, but not limited to: (i) the suitability of the organization's investment, relative to CalSTRS' investment guidelines and objectives; (ii) the quality, stability, integrity, and experience of the management team; (iii) the ability and willingness of the organization to dedicate sufficient resources and personnel to optimally manage CalSTRS' investments; (iv) the reasonableness of investment terms and conditions, including provisions to align interests of management and CalSTRS; (v) the appropriateness of management controls and reporting systems; and (vi) commitment to responsible contracting policies, workplace diversity and community involvement.

Consideration shall also be given to the financial strength of the investment manager, the level of client service given to CalSTRS, as well as changes within the managing organization such as the continuity of personnel assigned to CalSTRS' investments, among other items. Thus, it is not an asset class that will attract emerging manager involvement; however, it does attract many diverse managers due to its world-wide appeal.

Another factor in the design of this program is that its policy ensures that investors, managers, consultants, or other participants selected by CalSTRS take prudent and careful action while managing the Portfolio. CalSTRS believes that environmental, social, and governance, (ESG), issues can affect the performance of our investments. As a result, the CalSTRS 21 Risk Factors have been developed as a tool that both internal and external investment managers are expected to use to assess the impact of ESG risk when making an investment on behalf of CalSTRS.

In 2013, the CalSTRS Infrastructure program received second place for the 2012 *Global Infrastructure Investor of the Year* at the PEI Infrastructure Investor Awards.

Innovation and Risk

The Innovation and Risk unit was established in 2009 and made its first investments in December 2011. The Innovation team is tasked with researching and incubating strategies that are new to CalSTRS and expected to improve the risk-adjusted return of the total plan. Up to 2.5 percent of the total plan may be invested in Innovation strategies and each strategy may account for up to 0.5 percent of the total plan. To date, approximately \$1 billion has been invested in eight funds

encompassing discretionary global macro, risk-based allocation and long-biased commodity mandates.

Strategies are evaluated based on a number of qualitative and quantitative factors. Some of these factors include performance during equity or fixed income drawdowns and volatile periods, correlations to traditional market indices and liquidity. Once a strategy is determined to be potentially beneficial, it is incubated for up to three years with a small allocation of capital and a few managers. Managers are evaluated based on the quality of the team and organization, track record, willingness to share market information, and role in the portfolio among other considerations. ESG concerns are also taken into account. After the three year period, staff and the Investment Committee will discuss whether a strategy should become a larger part of the portfolio, studied further or discontinued.

Due to its small allocations, potentially brief investment period and early stage, the Innovation portfolio does not have a dedicated emerging manager program. However, staff consistently seeks to identify the most competitive and experienced partners to achieve the program's goals. Carrie Lo, Portfolio Manager, Chartered Financial Analyst and Chartered Alternative Investment Analyst, had been recognized for her work with the following national awards:

Institutional Investor 2012 Rising Star of Hedge Funds –

The Rising Stars of Hedge Funds are chosen annually by Institutional Investor magazine and represent up-and-comers whose accomplishments in, and contributions to, the industry

make them stand-out among their peers and position them as future industry leaders. 'Stars' are individuals who are playing an increasingly significant role in the hedge fund industry, either for a manager, an investor or a brokerage firm or other service provider.

Money Management Letter 2011 Rising Star of Public Funds

– The Rising Stars of Public Funds are relative beginners in the industry who are making great strides to aid their company or institution or making a difference to further the development of the industry as a whole. The individuals are nominated by their mentors, peers and others in the industry, with additional research and determination of the final list made by Money Management Intelligence.

One of the 50 Leading Women in Hedge Funds in a 2011

survey published by Hedge Fund Journal – The process of gathering nominations followed the pattern of previous surveys: the committee speaks to allocators, advisers, brokers, and service providers like administrators and law firms. Choosing the final fifty has always involved difficult decisions and qualitative assessments, but criteria included assets, performance, seniority, length of experience, and also the glowing references from nominators.

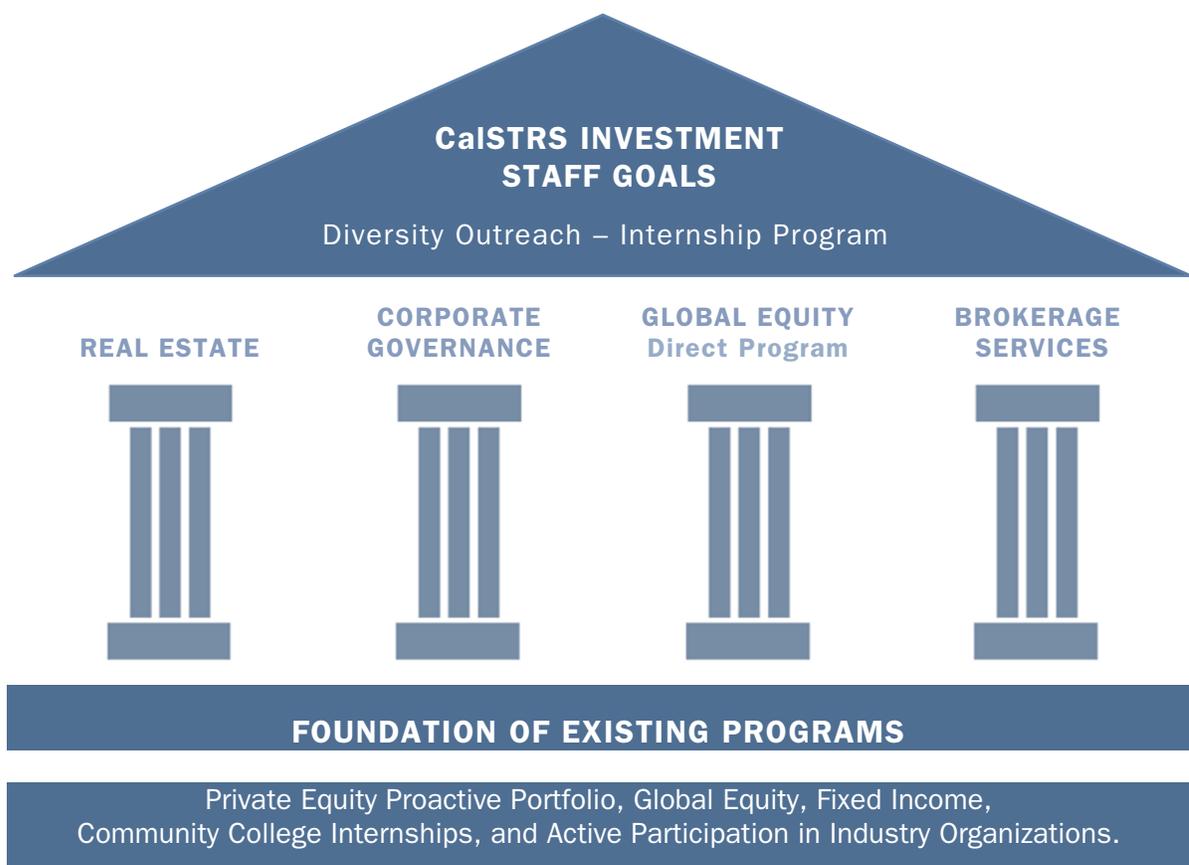
Conclusion

In closing, last December, CalSTRS was the first pension plan to be named to Pensions & Investments magazine's "Best Places to Work In Money Management" list. Of the 25 organizations on the nationwide list, CalSTRS was the only public entity. "I think this is a clear reflection of the respectful, collaborative and collegial culture we work

hard to create at CalSTRS,” said CalSTRS Chief Investment Officer Christopher J. Ailman. “Culture drives performance in any business, but especially the investment world.”

INVESTMENTS STRATEGIC GOALS

The CalSTRS Board approved a Strategic Plan for implementing the five-year business plan for Diversity in the Management of Investments on February 2013. Investments' DMI efforts for the next five years are depicted below.



Our strategic goals are in three segments:

- A. CalSTRS Investment Staff
- B. The challenges depicted in the pillars
- C. Our foundation of existing programs

A. Investment Staff

We have two goals with respect to Investment Staff.

Goal 1:

Increase the diversity of internal Investment Staff.

Initiatives

1. Develop a recruitment strategy to attract a diversified workforce reflective of California's growing population.
2. Develop a training process in all asset classes so as to provide a system to hire recent graduates from California Universities.
3. Develop training and development programs to retain current staff and attract civil servants from other disciplines.
4. Develop an internship program with local universities.

Measurement

Progress will be measured against the current benchmark. Please refer to Exhibits 2, 3, and 4.

2014 Progress Report

CalSTRS values diversification, not only as a key risk mitigation strategy in the management of the assets within the investment portfolio, but also in terms of the benefits an ethnically and gender-diverse internal investment team can provide in helping us meet our organizational performance objectives. It is because of the value that different backgrounds, experiences and ideas can add to the organization that the number one goal in our Strategic Plan for Diversity in the Management of Investments at CalSTRS is to continue to increase the diversity of internal Investment Staff.

The initiatives designed to help us meet our goal involve strategies to attract and retain a work-force that reflects our educator membership, which is predominantly female, and far more ethnically diverse than the institutional investment industry within which CalSTRS might traditionally recruit. In order to

maximize our resources toward this effort, our investment staff has and will continue to team with our human resources staff. Just this past December, a Diversity Coordinator was hired within CalSTRS' human resources branch and will work closely with investment staff to develop plans for a more targeted approach to reaching recent graduates from California Universities regarding employment opportunities within the investment branch. We have also experienced some success this past year in recruiting entry-level staff from other disciplines to the investment branch. Two of our Investment Officer 1's joined us this past calendar year from other programs within CalSTRS.

Exhibits 2, 3, and 4 can be used to measure progress toward meeting our goal of increasing the diversity of internal Investment Staff at CalSTRS. At 108 in 2013, the staff is virtually unchanged from 109 the previous year. Having said that, our gender diversity remains nearly split at 48 percent female and 52 percent male (see Exhibit 3 for details) and our ethnic diversity shows our continued commitment with 42 percent of our staff being ethnically diverse (see Exhibit 4 for details). Both of these figures compare favorably to our membership profile based upon the Department of

Education and the California Community College Chancellor's Office which placed estimates at 70 percent female and 30 percent ethnically diverse. While year to year numbers may not fluctuate much, CalSTRS Investments is committed to making continued progress toward this goal.

Goal 2:

Increase the awareness of a career in investments at California's high schools and community colleges.

Initiatives

1. Develop an outreach program with professional organizations aimed to attract diversity to the financial space, such as Robert Toigo Foundation, SEO, NASP, AAAIM and NAA.
2. Provide the resource of professional Investment staff at the highest levels to speak at events that include professional organizations aimed to attract diversity to the financial space, such as Robert Toigo Foundation, SEO, NAIC, NASP, AAAIM and NAA.

Measurement

Progress will be measured by the number of high school and community college students reached via the new program and/or events.

2014 Progress Report

For some time, CalSTRS Investments has made a comprehensive effort to mentor students from all walks of life, paying particular attention to ensuring the inclusiveness of ethnic and gender diverse students. We continue to reach out to these students through a student intern program in all levels of higher education – for post graduate, undergraduate, and community college – through local colleges and universities. The majority of the students involved in the program are from underrepresented groups on Wall Street.

One of our proudest accomplishment lies with the success of our internship program. In addition to our long-term traditional student intern program, during the summer of 2012 our Chief Investment Officer introduced the Senator Nell Soto Internship Program whereby an ethnically diverse student from a non-investment major was selected to work with him over the summer. Our inaugural intern, Sara Martinez, was a Social and Behavioral

Sciences major from Sacramento State University. Although the state hiring ban on student interns precluded us from continuing the Senator Nell Soto Internship Program into the summer of 2013, we look forward to pursuing another successful candidate in 2014.

Some of the recent efforts in this area where we will be providing the resource of professional investment staff at the highest levels are included in the following newer relationships:

Leaders On Fast Track (LOFT) – In 2003, CalSTRS CIO accepted to be a partner with the Hispanic Heritage Foundation's Leaders On Fast Track (LOFT) Finance initiative. The main objective of the initiative is to ensure that every young Latino interested in working in the financial services industry has at least one Latino to speak to about their relevant area of interest. In addition, they host finance boot camps, leadership trainings, and facilitate internships and jobs in the industry for interested Latinos. LOFT also has an online community where their most active members can connect. (<http://loftnetwork.org>).

The Rising Farmworkers Dream –

Last summer, the CIO and staff met with the leaders of The Rising Farmworkers Dream and accepted to be part of their effort whenever possible. This is a nonprofit organization that aims to leverage the power and resources of the business sector to enable positive social change within the American farm working community. They are a group of business managers, investors, entrepreneurs, political leaders, educators, and social advocates who invest in ventures that:

- » Focus on improving the social conditions of U.S. farm workers through business initiatives;
- » Increase access to human, social, and financial capital within the farm working community; and,
- » Have clear and accountable measures of investment return.

B. The Four Pillars

The four pillars represent some of the toughest challenges in incorporating DMI throughout the CalSTRS portfolio.

Goal 1:

Increase the diversity of Real Estate external managers who manage CalSTRS funds.

Initiatives

1. Conduct a study and survey the industry with the help of external advisors to establish the location, depth, and capacity of diverse real estate managers.
2. Design a program based on the results of the study that encompass best practices to include DMI in Real Estate.
3. Implement and measure results of the new program to increase diverse real estate managers.

Measurement

Initiatives began in 2012. Progress will be measured against the current benchmark. See Exhibit 1 and Exhibit 6.

2014 Progress Report

As part of the CalSTRS Investment Committee's 2012-13 Work Plan to review emerging manager participation within the portfolio, Staff retained Altura Capital to complete a study on the real estate emerging manager space and CalSTRS' efforts therein. Altura collaborated with Townsend, the Board's real estate consultant, and Staff to complete a report which was issued to the CalSTRS Investment Committee on April 12, 2013.

The [Emerging Manager in Real Estate Report](#) highlights the efforts of CalSTRS to date and the challenges of participating in the space. The report concluded that CalSTRS has a long-standing role as a leader in participating in the emerging manager space, having invested and committed a significant portion of the Real Estate program to emerging managers. As the market matures and more participants enter the space, however, improvement can be made.

Future efforts by CalSTRS in the emerging manager space will be focused on encouraging broader participation by all stakeholders.

Following a collaborative review of CalSTRS' efforts in the emerging manager space, the second initiative in the program evaluation process was executed. This phase of the process to increase diversity of real estate managers involved work on an implementation plan for the Real Estate emerging manager program. Staff presented its [Real Estate Emerging Manager Implementation Plan](#) report to the CalSTRS Investment Committee on November 8, 2013.

In the implementation report, staff focused on designing a more structured approach that would encourage and permit investment with smaller managers. Additionally a program monitoring and reporting process was outlined to provide updates to the Investment Committee semi-annually. Staff also remained committed to working with CalSTRS' peers and business partners to encourage greater industry diversity. Real Estate staff will begin implementation of its emerging manager program in 2014.

Goal for Pillar 2:

Increase the diversity of Corporate Boards

Initiatives

1. Implement and market the Diverse Director Database (“3D”) and survey the industry with the help of external advisors to establish the location, depth, and capacity of diverse real estate managers.
2. Assess the diversity of corporate boards by conducting a survey of current women and people of color with the top corporations where CalSTRS has investments.

Measurement

Initiatives began in 2009. Progress will be measured by the number of women and people of color appointed to corporate boards from all sources, including the 3D Database.

2014 Progress Report

CalSTRS and CalPERS partnered to create 3D, the first director candidate database where candidates can self-nominate at no cost. This reduces the anecdotal nature of board appointments and broadens the pool of qualified candidates that gets presented to boards when vacancies do occur. It also helps to reduce the homogeneity bias and works against “group think”, which was so detrimental to investors in the last financial crash. The 3D database has been fully operational since September 2012 and now has 655 qualified diverse candidates; many of these candidates already serve on at least one board, so they are proven, quality candidates.

Staff has assessed the addition of new directors added to the companies in the R3000 and the

percentage of new women directors as the measure of diversity in the top corporations in the CalSTRS portfolio. Women are considered a proxy for diversity generally since it is difficult to reliably report/study individuals’ ethnicity/ race. The table below shows the state of diversity in the Russell Indexes for the last three year period and does reflect steady improvement.

Our plans for the future include continuing to assess the diversity of corporate boards relative to new directors/new women/diverse directors within CalSTRS portfolio on an aggregate basis. GMI, a noted Corporate Governance Research vendor and a partner with CalSTRS in 3D, performs annual surveys of the R1000, 2000 and 3000 for CalSTRS. The portfolio assessment will be completed at the end of each calendar year.

	Russell 1000 Companies			Russell 2000 Companies			Russell 3000 Companies		
	New Directors	New Women Directors	% of New Women Directors	New Directors	New Women Directors	% of New Women Directors	New Directors	New Women Directors	% of New Women Directors
2011	522	88	17%	770	113	15%	1292	201	16%
2012	443	88	20%	649	107	16%	1092	195	18%
2013	725	170	23%	1054	185	18%	1779	355	20%

Source: GMI Assessment Board Diversity/New Women/Diverse Directors

- » CalSTRS active and direct engagements led to 14 diverse director appointments to company boards in the one year period, 2012-2013. Some of the companies that made these appointments include QEP Resources, Noble Energy, Quanta Services, Riverbed Technology, Crane Co. and American Financial Group.
- » We intend to expand our portfolio engagement to include a greater number of public companies and the private asset classes as well. In the long-run, long-term investors who own all classes of assets should benefit from taking a universal approach to systemic value enhancing issues such as diversity on corporate boards.
- » CalSTRS intends to increase its partnership experience, which is already substantial in this area as a way of accelerating the pace of increasing diversity on corporate boards. CalSTRS has actively partnered with a number of organizations, including the National Association of Securities Professionals, New America Alliance, and the 30 percent Coalition.

CalSTRS has been and continues to be the leader in the Diversity on Corporate Boards issue, especially as it relates to the enhancement of shareholder value. Going forward we will continue to build on our success, expand the reach of 3D into our private market portfolios, and educate our GPs in the private asset classes on the benefits of diversity on boards and in management in companies before they enter the public market.

Lastly, CalSTRS encourages its portfolio companies to use 3D as a resource for board searches and has had at least one company subscribe, as well as one of its investment managers.

Goal for Pillar 3:

Develop a direct relationship program whereby developing equity managers in the CalSTRS Manager-of-Managers (MoM) structure can be hired from the Developing Manager Program to the Core Portfolio.

Initiatives

1. Develop direct relationship program options for consideration.
2. Review options in consideration of state procurement process.
3. With input from Manager-of-managers, select most viable option.
4. Implement and measure results of direct relationships with emerging managers and report findings.

Measurement

Initiatives are scheduled to begin in 2013. Progress will be measured against the current benchmark and number of direct emerging manager relationships. See Exhibits 1 and 6.

2014 Progress Report

CalSTRS invests with developing managers to capture alpha potential, to provide more opportunities for newer and smaller firms, and to access new talent and future manager capacity. However, as developing managers experience success and the concomitant growth of assets under management, they run the risk of no longer “qualifying” as developing managers and being eliminated from the developing manager program. Along with the incorporation of developing managers into its Global Public Equity portfolio, CalSTRS’ ultimate goal is to allow managers who have performed well (in terms of investment performance and overall business operations) to move to direct relationships with CalSTRS when there is a need for a specific asset class or investment style in the portfolio. Since the implementation of the DMI Strategic Plan, we have gathered input from our current managers-of-managers (MOMs) and other stakeholders and have developed several direct relationship program options for consideration. With ongoing input from various constituencies, including MOMs, and in respect of the state procurement process, we will select the most viable option and implement a direct

relationship process. Once this process is in place, staff will continuously monitor and measure results of direct relationships with developing managers and report findings.

Goal for Pillar 4:

Increase the diversity of firms providing brokerage services to CalSTRS.

Initiatives

1. Commission a study of best practices in brokerage trading and how to best increase utilization of women- and minority-owned brokerage services.
2. Adjust our practices based on the results of the study and monitor and measure results.

Measurement

Initiatives are scheduled to begin in 2013-14. Progress will be measured against the current benchmark and the increased utilization of women- and minority-owned brokerage services. See Exhibits 1 and 6.

2014 Progress Report

Initial discussions on the initiatives for this goal have revealed that it is a project that will engage both Fixed Income and Global Equity. Research and analysis that will yield recommendations will commence during the fourth quarter, 2014.

C. The Foundation

The foundation for CalSTRS Diversity in the Management of Investments (DMI) strategy consists of the existing programs: the Private Equity Proactive Portfolio, Global Equities Developing Manager Program, Fixed Income direct relationships with diverse managers, local Community College internships, and active participation in industry organization.

Goal 1:

Continue DMI efforts in Private Equity Proactive Portfolio and achieve an absolute return of 7.5 percent and/or outperform the private equity benchmark.

Initiatives

1. Manage, monitor and evaluate side-by-side investments.
2. Manage, monitor, and evaluate the fund-of-funds structure.

Measurement

Progress will be measured against the current benchmark. See Exhibits 1 and 6.

2014 Progress Report

For 2013, the total Private Equity asset class returned 19.2 percent for the year while continuing to support DMI efforts via the Proactive Private Equity Portfolio during 2013. The proactive private equity portfolio returned 7.9 percent, which exceeds Goal 1 by beating the absolute return of 7.5 percent. We continued to manage, monitor and evaluate side-by-side investments.

During the year, the CalSTRS private equity asset class made direct commitments of approximately \$2 billion to seventeen unique private equity funds. Sixteen of the seventeen

fund management teams included either female or ethnic minority representation, and two were also emerging managers.

As for indirect investments via the Proactive Private Equity Portfolio's fund-of-fund vehicles, there were seven funds closed in 2013 for a total of \$71 million in commitments. Of the seven firms, five fund management teams included female or ethnic minority representation, and six were emerging managers.

Goal 2:

Continue DMI efforts in the Global Equity Developing Manager Program and exceed the assigned benchmark for the manager.

Initiatives

Manage, monitor, and evaluate the manager-of-manager structure.

Measurement

Progress will be measured against their current benchmark. See Exhibits 1 and 6.

2014 Progress Report

Within the context of CalSTRS Global Public Equity portfolio, diversification is a key consideration; not only in terms of achieving returns and mitigating risk, but also in terms of the benefits that different backgrounds, experiences and ideas can add to the overall performance of the portfolio. Numerous studies indicate that developing managers tend to perform better across asset classes — with similar or less risk than larger, established firms, thereby potentially adding another important facet of diversification to the Global Public Equity portfolio.

The initiatives designed to help us meet our goal consist of finding and incorporating developing managers into the Global Public Equity portfolio. To complement our internal resources and get the most out of our efforts to meet our goals, our investment staff has and will continue to work with managers-of-managers (MOMs) in the developing manager arena. Since these initiatives were put in place, we have contracted with six MOMs, currently encompassing 49 developing managers and \$2.6 billion in assets. Of these six MOMs, five are developing firms themselves. These MOMs

work closely with investment staff by designing manager portfolios to fulfill various mandates within the overall portfolio and are currently helping staff to develop a process for establishing direct relationships with those developing managers that may qualify for mandates outside the developing manager portfolio. We will continue to work with these MOMs to further develop and refine our strategy throughout 2014 and beyond.

Since inception of the developing manager program and as of December 31, 2013, five out of six MOM portfolios have beaten their respective benchmarks, while one has underperformed. CalSTRS Global Equity is committed to making continued progress toward this goal and will continue to monitor, rebalance and reevaluate these managers.

Goal 3:

Continue active participation in industry organizations.

Initiatives

Attend and participate in the efforts of organizations that focus in diversity in the

management of investments. Including, but not limited to:

1. The Robert Toigo Foundation whose vision is to Change the Face of Finance
2. The National Association of Investment Companies (NAIC)
3. The National Association of Securities Professionals (NASP)
4. The New American Alliance (NAA)
5. The Association of Asian American Investment Managers (AAAIM)
6. Pacific Pension Institute (PPI)

Measurement

Progress will be measured on an annual basis by active participation with the various organizations.

2014 Progress Report

In 2003, CalSTRS has attended and participated in the efforts of several organizations that focus on diversity in the management of investments. Some specific highlights include:

- » **National Association of Securities Professionals:** NASP is a professional organization whose mission is to serve

as a resource for the minority community at large to share information about the securities and investments industry, by providing opportunities to share information about the securities markets, including functioning as a repository for information regarding current trends, facilitating fundamental education seminars, and creating networking opportunities.

On March 13, Solange F. Brooks, Portfolio Manager, attended and participated on a panel of the NASP, Southern California Chapter Third Annual Day of Education in Private Equity discussing SB 294 and its effect on investments. The proceeds of this event go to scholarships for students; this year seven student currently in college and recipients of previous awards received \$1,000 scholarships to help defray expenses for their current school year.

- » **The Association of Asian American Investment Managers:** AAAIM is dedicated to elevating and increasing the

visibility of Asian American investment professionals to institutional funds.

October 21 & 22: Four CalSTRS staff attended and participated in AAAIM's National Conference: Roadmap to Success – Investing in a Global Recovery. Lisa Kashiwamura, Investments Staff Services Analyst, participated in the Young Professionals Workshop, during the first of the conference aimed at providing an opportunity for those just starting their careers to learn from professional development experts and people who have built their careers in the field. Christopher J. Ailman, Chief Investment Officer, participated on a panel that discussed the state of the world economy, and where smart investment opportunities around the world are found. Also on a panel was Solange F. Brooks, Portfolio Manager, where she discussed current efforts to support emerging managers who have taken the bold step of starting their own funds. Margot Wirth, Director of Private Equity, also attended.

- » **Robert Toigo Foundation:** The Foundation's mission is to change the face of finance by fostering leadership development, educational success, and accelerated career opportunities for diverse finance professionals.

August 15: Christopher J. Ailman, Chief Investment Officer, was the key note speaker at the Toigo Institute for Leadership Excellence, Advancement & Diversity. Mr. Ailman provided his views regarding industry insights for risk, reward, and style. Mr. Ailman is also part of the Foundation's Advisory Board.

Solange F. Brooks, Portfolio Manager, serves as Chair of the Advisory Board of the Toigo Foundation, and as such is part of several key meetings throughout the year and attended their annual event, the Toigo Gala.

- » **New America Alliance:** NAA is dedicated to advancing economic development of the American Latino Community. The Alliance is organized on the principle that American Latino business leaders have a special

responsibility to lead the process of building the forms of capital most crucial to Latino progress – economic capital, political capital, human capital and the practice of philanthropy.

On an annual basis, CalSTRS CEO, CIO and Investment staff host a meeting with the NAA President Maria del Pilar Avila and a group of NAA members to chat about the state of both organizations, projects for the year and ways in which they can help each other. The 2013 meeting was held on May 7, and important matters were discussed and new opportunities were vetted.

Also, staff attended and participated in the 13th Annual Wall Street Summit, NAA's key event. Those attending included the Chief Deputy CIO, Michelle Cunningham, and the Director of Risk and Innovation, Steven Tong. CIO Christopher Ailman and Solange F. Brooks, Portfolio Manager, participated as speakers.

Lastly, our two funds-of-funds in private equity, Bank of America Merrill Lynch Capital Access Funds (BAML CAF) sponsor events aimed at emerging managers.

- » Michael Warmerdam, Investment Officer, participated in a networking event sponsored primarily by BAML CAF with the coordination of AAAIM, NAA, NAIC and NASP, thus, leveraging the relationship with all these important organizations. He also represented CalSTRS Investments in an event co-sponsored/hosted by BAML CAF and the Initiative for a Competitive Inner City (ICIC) where the program is designed to provide companies with educational tools and coaching on what equity capital is, what equity capital providers are looking for, what are the key elements of a company presentation and how best to go about raising equity capital. The event also facilitates the connections between inner city entrepreneurs and equity capital investors.

- » Invesco Private Capital hosts a one-day conference called Tools for Success, on an annual basis, to focus on emerging managers and a practical presentation and discussion about tools that can be utilized when raising a private equity fund for the first time. Solange F. Brooks, Portfolio Manager, was a speaker at the 2013 San Francisco event. Investment Officers Michael Warmerdam and Robert Ross, and Kristian Altier also attended representing CalSTRS Private Equity.

INVESTMENTS PERFORMANCE BENCHMARKS

To facilitate the periodic reporting to the CalSTRS Investment Committee and to provide a relative measure to gauge success, custom performance benchmarks are approved by the Investment Committee. The approved custom performance benchmarks are shown below:

Exhibit 1 CalSTRS Portfolio Performance Benchmarks¹

Public Global Equity – Weighted blend of the Russell 3000 Index combined with the MSCI ACWI Non US Index

Fixed Income – (95%) Barclays Capital U.S. Aggregate + five percent (5%) U.S. High Yield Cash Pay two percent (2%) Issuer Constrained Index

U.S. Core – Barclays Capital U.S. Aggregate Index

U.S. Core Plus Debt – Barclays Capital U.S. Universal Index

Inflation Sensitive – Weighted blend of Global Inflation Protected Linked securities and infrastructure index

Real Estate – NCREIF-ODCE – Value Weighted Index Net of Fees

Private Equity – Russell 3000 Index plus 300 basis points and the State Street Private Equity Index cumulative pooled internal rate of return data weighted by sub-asset type

Absolute Return – 90-day Treasury Bills plus 100 basis points, but the overall objective is not as important as each portfolio and subcomponent respective benchmark

CaSTRS Investment Staff

As of December 31, 2013 CaSTRS Investments consists of 108 state civil servants led by the Chief Investment Officer, California State Teachers' Retirement System in the following investment classifications.

Exhibit 2

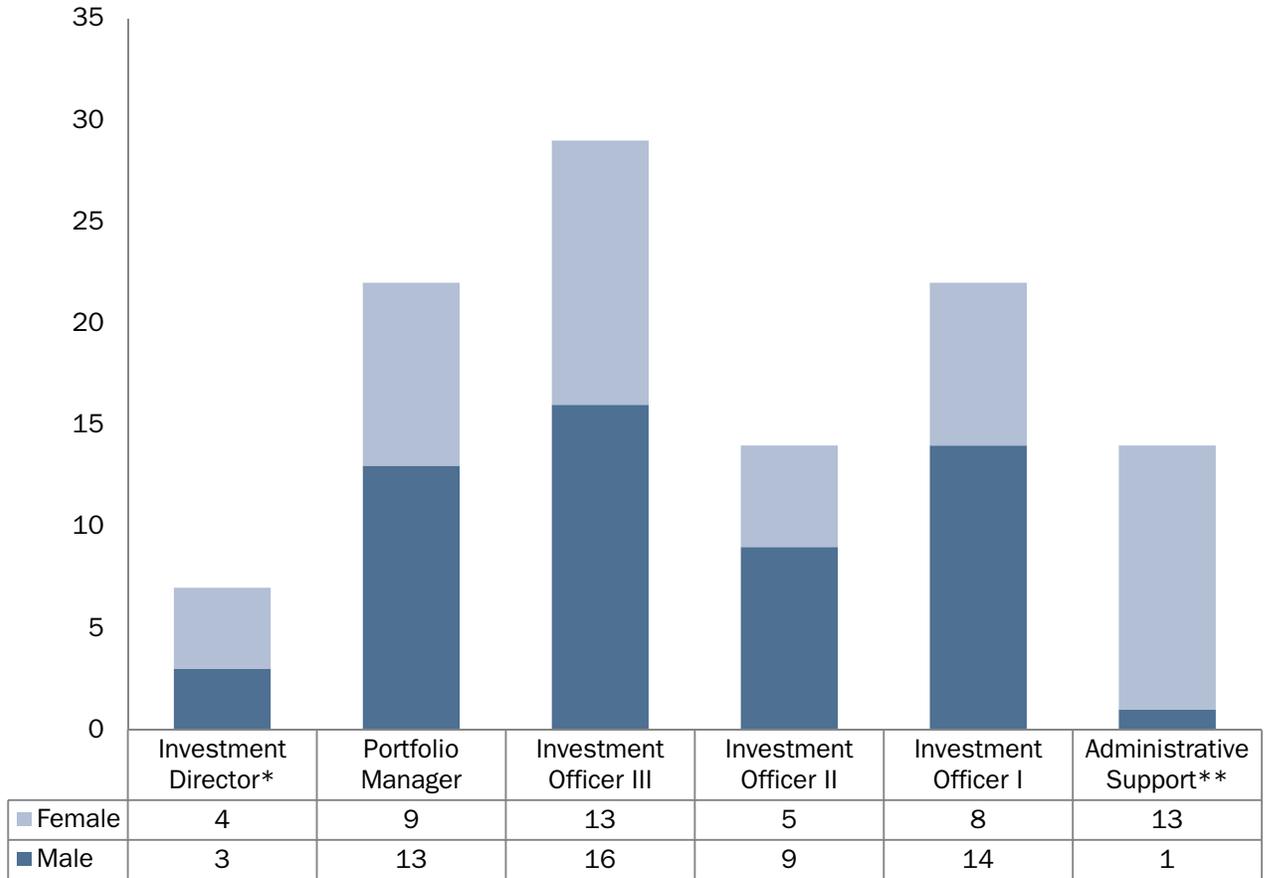
CaSTRS Investments: A California State Civil Service Workforce

Class Title	Schematic Code	Class Code	Number of Staff
Chief Investment Officer, CaSTRS	JV57	4693	1
Investment Director, CaSTRS	JV58	4694	5
Portfolio Manager, CaSTRS	JV59	4697	22
Investment Operations Director, CaSTRS	JV16	4699	1
Investment Officer III, CaSTRS	JV17	7684	29
Investment Officer II, CaSTRS	JV31	7339	14
Investment Officer I, CaSTRS	JV36	7338	22
Associate Governmental Program Analyst	JY35	5393	1
Staff Services Analyst	JY20	5157	4
Administrative Assistant II	KG30	5358	1
Administrative Assistant I	KG40	5361	5
Executive Assistant	CD40	1728	2
Office Technician	CA48	1138	1
Total Investment Staff			108

Source: CaSTRS personnel data as of December 31, 2013

CalSTRS Investments: A Gender Diverse California
State Civil Service Workforce

Exhibit 3



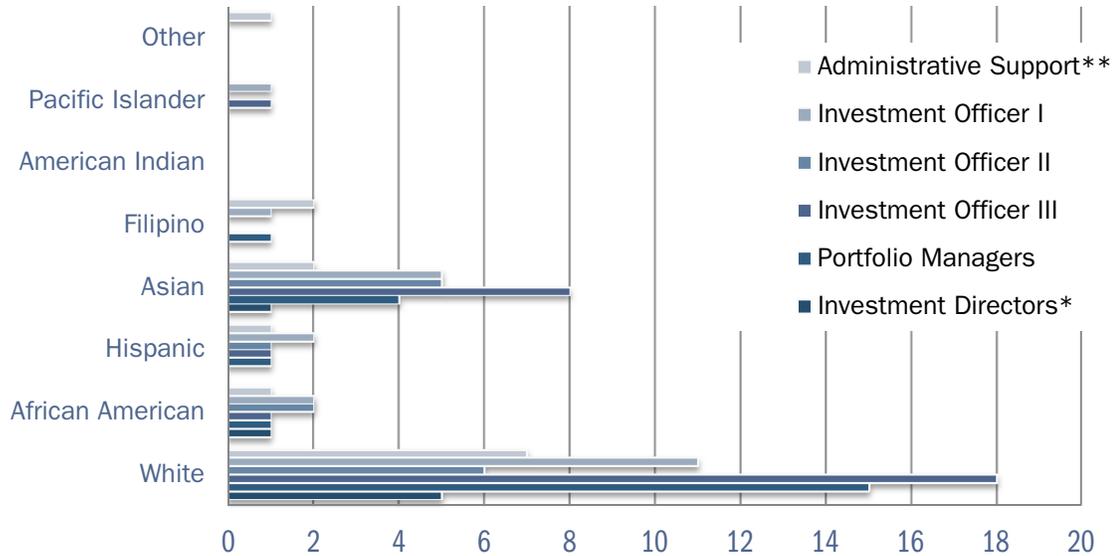
Source: CalSTRS personnel data as of December 31, 2013

* Investment Directors consists of the following California State Teachers' Retirement System classifications: Chief Investment Officer, Investment Director, and Investment Operations Director.

** Administrative Support consists of the following classifications: Associate Governmental Program Analyst, Staff Services Analyst, Administrative Assistant II, Administrative Assistant I, Executive Assistant, and Office Technician.

CalSTRS Investments: An Ethnically Diverse
California State Civil Service Workforce

Exhibit 4



	White	African American	Hispanic	Asian	Filipino	American Indian	Pacific Islander	Other
Administrative Support**	7	1	1	2	2	0	0	1
Investment Officer I	11	2	2	5	1	0	1	0
Investment Officer II	6	2	1	5	0	0	0	0
Investment Officer III	18	1	1	8	0	0	1	0
Portfolio Managers	15	1	1	4	1	0	0	0
Investment Directors*	5	1	0	1	0	0	0	0

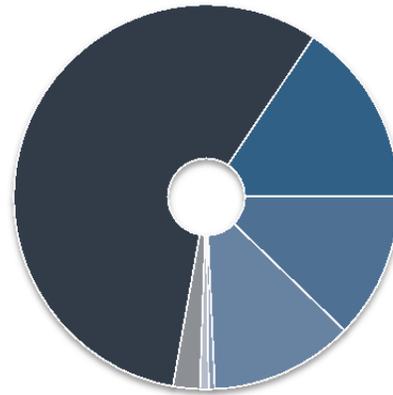
Source: CalSTRS personnel data as of December 31, 2013

* Investment Directors consists of the following California State Teachers' Retirement System classifications: Chief Investment Officer, Investment Director, and Investment Operations Director.

** Administrative Support consists of the following classifications: Associate Governmental Program Analyst, Staff Services Analyst, Administrative Assistant II, Administrative Assistant I, Executive Assistant, and Office Technician.

Exhibit 5 CalSTRS Investments: Asset Allocation

- 56.6% Global Equity
- 15.5% Fixed Income
- 12.3% Real Estate
- 12.1% Private Equity
- 0.5% Inflation Sensitive
- 0.7% Absolute Return
- 2.3% Liquidity



Source: My State Street as of December 31, 2013

CalSTRS Investments: Emerging Manager Definitions

Exhibit 6 by Asset Class

	Emerging Definition	Minimum Qualifications
Money Managers	Firm must have \$2 billion or less in assets under management (AUM) at initial funding. Firm must have a maximum of 55 percent non-employee-owned ownership.	Firm must be a legally structured entity with a corporate Tax Identification number. Firm must be a Registered Investment Advisor (RIA) or must qualify for exemption from registration.
Private Equity Funds	Firm must be a 1st, 2nd, or 3rd time private equity institutional fund, and raising a fund under \$1 billion. Firm must have a maximum of 55 percent non-employee-owned ownership.	Firm must be a legally structured entity with a corporate Tax Identification number. Firm must have a Private Placement Memorandum in place.
Fund of Private Equity Funds	Firm must have \$3 billion or less in assets under management (AUM). In addition, the firm must have: a) A maximum of 55 percent non-employee-owned ownership, or b) Be a fund that is specifically focused on emerging private equity funds.	Firm must be a legally structured entity with a corporate Tax Identification number. Firm must have a Private Placement Memorandum in place or a similar proposal, in the event of a separate account relationship.

Emerging Definition

Real Estate Partnerships	Firm must have \$1 BN or less in assets under management (AUM). Firm must have a maximum of 67 percent non-employee-owned ownership.
REITs	Firm must have \$500 million or less in assets under management (AUM). Firm must have a maximum of 55 percent non-employee-owned ownership.
Hedge Funds	Firm must have \$1 billion or less in assets under management (AUM) or have up to one existing institutional investor. Firm must have a maximum of 55 percent non-employee-owned ownership.
Investment Management Consultant	Firm must have \$10 billion or less in assets under consulting/advisement. Firm must have a maximum of 55 percent non-employee-owned ownership.

Minimum Qualifications

Firm must be a legally structured entity with a corporate Tax Identification number. Firm must have a Private Placement Memorandum in place, or have similar proposal in the event of a separate account relationship.
Firm must be a legally structured entity with a corporate Tax Identification number. Firm must be a Registered Investment Advisor (RIA) or must qualify for exemption from registration.
Firm must be a legally structured entity with a corporate Tax Identification number.
Firm must be a legally structured entity with a corporate Tax Identification number. Firm must be a Registered Investment Advisor (RIA) or must qualify for exemption from registration.

Emerging Definition

Investment Research Firms Firm must have a maximum of 55 percent non-employee-owned ownership.

Emerging Manager Program Managers Firm must have \$8 billion or less in assets under management (AUM) Firm must have a maximum of 55 percent non-employee-owned ownership.

Broker-Dealers Firm must have \$25MM or less in annual commissions. Firm must have \$50MM or less in Net Equity Capital as defined by the NASD. Firm must have a maximum of 55 percent non-employee-owned ownership.

Minimum Qualifications

Firm must be a legally structured entity with a corporate Tax Identification number. Firm must be a Registered Investment Advisor (RIA) or must qualify for exemption from registration.

Firm must be a legally structured entity with a corporate Tax Identification number. Firm must be a Registered Investment Advisor (RIA) or must qualify for exemption.

Firm must be a legally structured entity with a corporate tax Identification number. Firm must be a NASD registered firm.

Source: CalSTRS staff as of December 31, 2013

ADVISOR

Altura Capital



CalSTRS' CIO, Christopher J. Ailman, has a pool of advisors for use throughout the year, each one specializing in a particular area, catering to CalSTRS' specific and unique needs. Of that pool, Altura Capital, headed by Monika Mantilla Garcia, distinguishes itself for being a leader in research and provider of investment solution and advisory services within the emerging and diverse manager space. As a founding subscriber, CalSTRS has a long-standing relationship with Altura Capital, about eight years, and we are excited to continue being supportive and active in seeking new ideas and concepts. In addition, Solange F. Brooks, CalSTRS Portfolio Manager, currently sits in the Advisory Board for Altura Capital. www.alturacap.com.

GLOBAL EQUITY

MARKET VALUE
\$102.5 Billion

% OF OVERALL PORTFOLIO
(Equities/Total Fund):
56.6%

DEVELOPING MANAGER
PROGRAM:
\$2.6 Billion Market Value
Represents approximately
11% of the total \$23.9 Billion
active U.S. Equity Portfolio

The Developing Manager Program was established in 2004 to take advantage of a new source of alpha that smaller and newer firms could potentially generate for the Portfolio. CalSTRS currently has direct contractual relationships with six manager-of-manager firms, five of which are minority and/or women owned firms. These six manager-of-manager firms have underlying relationships with approximately 49 developing managers, 27 percent, or 13, of which are minority-owned firms and 22 percent, or 11, are women-owned firms.

Investment Opportunity Review Process

- » After identifying a business need for a specific type of product in the portfolio, CalSTRS posts an advertisement of a solicitation on CalSTRS.com.
- » Potential managers are given approximately two weeks to enter or update information in a specified database. Staff screens for qualified managers in the defined universe in the database based on the basic qualifications specified in the solicitation advertisement. The initial screen is finalized by selecting the top candidates based on CalSTRS defined criteria.
- » Those managers who are identified at this stage are invited to submit due diligence questionnaires to

*Source: My State Street
as of December 31, 2013*

CalSTRS. Staff reviews the submitted questionnaires and verifies the accuracy of the information.

- » Staff then scores all of the submitted proposals, and finalists are selected and invited for an interview at CalSTRS. The top scoring managers after the finalist interviews are subject to due diligence on-site inspections and negotiation of contract terms. Managers who are not selected for an initial funding are placed in the pool and may be funded at a future date based on the Portfolio's needs.

FIXED INCOME

ASSETS UNDER
MANAGEMENT¹

\$28.1 Billion Market Value

% OF OVERALL PORTFOLIO
(Fixed Income/Total Fund):
15.5%

EMERGING MANAGERS
Assets Under Management:
\$489 Million Market Value
Represents approximately
10% of the total externally
managed Fixed Income
Portfolio

Over 80 percent of CalSTRS Fixed Income Assets are managed internally. With respect to diversity, CalSTRS has a long-standing “open door” policy of using a diverse group of broker/dealers to execute trades, and as a result currently does business with approximately 18 emerging/developing firms, and all of our trades are done in a competitive environment.

CalSTRS Fixed Income does not have a dedicated program to Emerging Managers; however, our selection process has evolved over time to facilitate the evaluation/consideration of a broad universe of managers (regardless of AUM) into the Portfolio based upon quantitative and qualitative factors that are indicative of a successful asset management business partner.

Another aspect of diversity is gender; the Fixed Income Team is comprised of 55 percent females and 45 percent males. Among these employees 45 percent are also classified as minorities.

Investment Opportunity Review Process

- » Based on our belief that investment opportunities can appear in both large, small, and start-up firms, Fixed Income has established a process and a team of investment professionals to review all new investment opportunities in either fund or separate account form.

*AUM from Blackrock®
as of November 30, 2013.
Percentage of portfolio represents
NAV from My State Street
as of December 31, 2013.*

Each strategy is reviewed for strategic fit, risk, and overall alpha opportunity. All opportunities, encompassing several different strategies, were reviewed and logged into the Opportunities database. Since inception this database has grown to capture over 313 investment opportunities. This process was designed to not only facilitate access to CalSTRS for all managers, but to also serve as a way for us to assess opportunities and market conditions.

PRIVATE EQUITY

MARKET VALUE
\$21.7 Billion

% OF OVERALL PORTFOLIO
(Private Equity/Total Fund):
12.1%

PRIVATE EQUITY
PROACTIVE PORTFOLIO
Assets Under Management:
\$1.6 Billion

Represents approximately
7.2% of the total Domestic
Private Equity Portfolio's
Assets Under Management

The Private Equity Proactive Portfolio contains the strategy interwoven in all asset classes within CalSTRS portfolio whereby a framework is provided for selecting investments in an opportunistic and disciplined manner when these investments are in (1) the emerging space, and/or (2) to capture innovative strategies (i.e., new market opportunities and/or new drivers of value creation due to changing demographics, etc.), and/or (3) investments consistent with the Board's Policy on California Investments.

The Private Equity Proactive Portfolio includes two fund-of-funds managers, each with three investment vehicles: The CalSTRS/Bank of America Capital Access Funds, and the New and Next Generation Funds managed by Invesco Private Capital. Both fund-of-fund management teams are ethnically diverse. As for their underlying fund investments, 95 percent are with emerging managers, and 71 percent of the managing firms include women or ethnic minority representation on their management teams.

The Private Equity Proactive Portfolio also includes thirteen direct private equity fund investments. Of these, 85 percent are with firms with managing teams that include women or ethnic minority representation on their management teams, and 69 percent are emerging manager funds.

*Market Value and AUM figures
taken from PrivateEdge®
as of September 30, 2013.
Percentage of portfolio represents
NAV from My State Street
as of December 31, 2013.*

Investment Opportunity Review Process

CalSTRS requires that two independent due diligence tracks and approvals be reached before a direct commitment is made to any fund. One track is by the advisor, and the other is CalSTRS staff. Both have to agree, or the deal does not get done. Thus, we highly encourage funds to begin with our advisors first – the process is fashioned to be effective and efficient, targeting and making the best use of time. Below are all the advisors to CalSTRS private equity:

- » Proactive Portfolio – US underserved space mandate – Bank of America Merrill Lynch Capital Access Funds. You may send your PPM to Edward Powers at edward.powers@baml.com.
- » Proactive Portfolio – US new and next generation managers (first, second or third-time funds) – Invesco Private Capital. You may send your PPM to Amit Tiwari at amit_tiwari@invesco.com.
- » Core Portfolio – US, Latin American and/or Asian Offering – Cambridge Associates, LLC. You may direct your PPM to: CalSTRSteam@cambridgeassociates.com.
- » Core Portfolio – European and Middle Eastern Offerings – Altius Associates. You may direct your PPM to: jh@altius-associates.co.uk.

REAL ESTATE

ASSETS UNDER
MANAGEMENT

\$22.2 Billion Market Value

% OF OVERALL PORTFOLIO
(Real Estate/Total Fund):
12.9%

U.S. EMERGING
MANAGERS

Assets Under Management:
\$7 Billion Market Value
Represents approximately
38.5 % of the total \$18.5
Billion U.S. only Real Estate
Portfolio

CalSTRS has been investing with emerging real estate managers since 2001. Approximately 38.5 percent of the current portfolio is invested with emerging managers. Believing there is no single correct method for investing with emerging managers; CalSTRS invests via joint ventures, fund-of funds and managers-of-managers to provide the widest exposure. In 2013, CalSTRS completed a review of how it invests with emerging real estate managers and will implement the review findings now and in the future.

Investment Opportunity Review Process

- » Upon determination that an opportunity may be suitable for CalSTRS' investment objectives, staff will decide whether it is appropriate to pursue a direct commitment to the opportunity, or to refer the opportunity to an existing partner funded with CalSTRS equity.
- » If an emerging manager has a successful track record and a strong prior background of investing institutional capital, CalSTRS staff may consider a direct investment with that manager. If, however, the emerging manager has yet to garner significant institutional investment experience, staff may refer the firm to one or more of several existing CalSTRS partners, with the aim of funding the emerging

*AUM from PrivateEdge®
as of September 30, 2013.
Percentage of portfolio represents
NAV from My State Street
as of December 31, 2013.*

manager through the existing partner until sufficient institutional experience is acquired to merit a direct relationship with CalSTRS.

- » CalSTRS Real Estate has also invested in certain funds-of-funds and manager of managers which specifically seek to direct the System's capital to emerging managers. Staff will continue to seek out such managers going forward.
- » It is expected that emerging managers selected by CalSTRS Real Estate and its partners will reflect the rich diversity found within the United States, as such diversity should bring not only varied skills and investment approaches but also broader perspectives into the investment process
- » The goal of the Real Estate Program is to invest in and with (small) Emerging Managers who need capital and infrastructure to grow their businesses to an institutional level. CalSTRS intends to provide a link between institutional capital and local, emerging managers, including minority and woman-owned firms to create a diversified, risk-controlled, multi-manager investment portfolio.